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SUBJECT: BANGLADESH PARTIALLY INSULATED FROM GLOBAL FINANCIAL CRISIS
- FOR NOW

Summary

¶1. (SBU) Despite a sharp drop in local stock markets on October 12, Bangladesh's economy is relatively insulated -- for now -- from the effects of the global financial crisis, according to local economists and bankers. Should a global recession last for an extended period, however, Bangladesh could see a slowdown in several areas, including the key drivers of its economy, garment exports and remittances.

Impact likely to be minor in the short term

¶2. (U) Until October 12, Bangladesh's financial markets remained largely unaffected by the meltdown of the financial sector in the United States, Europe and parts of Asia. Key stock indices fell by one to two percent the week of October 5, more the result of a change in loan ratios by some local banks than a response to the global crisis. When markets opened on the 12th, however, the benchmark Dhaka Stock Exchange index fell by 3 percent, the largest one-day drop in four months. This decline appears to be a reaction to last week's steep declines in major stock markets worldwide. Stocks rebounded somewhat October 13; main indices gained about 1 percent.

¶3. (U) The head of the Dhaka Stock Exchange told the media on October 13 there was no reason for panic among Bangladesh portfolio investors, mainly because Bangladesh financial institutions were not strongly integrated into world markets. Foreign portfolio investment accounts for less than three percent of the total market capitalization of the nation's stock markets. Also, capital controls here restrict Bangladesh portfolio investment abroad.

¶4. (U) Similarly, Bangladesh's commercial banks, as well as its central bank, have limited exposure to the crisis. One local economist reported that the central bank, Bangladesh Bank, held its foreign currency reserves in cash and U.S. Treasury bills. Local commercial banks have an estimated $500 million in foreign currency holdings, none of which is held in the highly speculative financial instruments that have brought down some of the world's largest investment banks. In addition, many commercial banks with funds in overseas banks are moving these funds to Bangladesh Bank.

¶5. (U) According to local bankers and economists, the most important thing Bangladesh must do in the short term is manage its exchange rate in the wake of exchange rate fluctuations in key world currencies and the currencies of Bangladesh's neighbors. And as credit freezes worldwide, at least one economist expressed concern that developing countries like Bangladesh might experience constraints on trade finance, which keeps international trade -- including exports of products like garments - functioning smoothly.

Greater impact possible in the long term

¶6. (U) Should the financial crisis lead to a lengthy global recession, Bangladesh's economy could be harmed more greatly, according to local experts. They expressed concern about the impact on Bangladesh's critical ready-made garment (RMG) industry, which exported more than $10 billion in garments in fiscal year 2008, mainly to the United States and Europe. As consumer spending in the United States and Europe declines, RMG orders could fall; often unreliable local media reported a decrease in orders by JCPenney and the closure by The Gap, Ann Taylor, Lane Bryant and others of stores in the United States. The media reports speculated these developments could reduce the $3.2 billion in Bangladesh garment exports to the United States.

¶7. (SBU) On the other hand, Bangladesh exports mostly medium- to low-end apparel, towards which consumers could gravitate despite reduced consumption or disposable income. One expatriate apparel buyer told Econoff that many manufacturers had orders through January 2009. After that, however, orders could decline. Alternatively, the buyer said, large apparel outlets could place more orders of smaller quantities throughout the apparel season as a way of hedging against lower retail sales, rather than the usual practice of one huge order at the beginning of a season.

Remittances

¶8. (U) Bangladesh's economy also relies heavily on remittances from overseas workers, most of whom work in the Persian Gulf. In the last fiscal year, overseas remittances to Bangladesh exceeded $8

billion, and some experts have predicted remittances could reach $10 billion this fiscal year. Should falling oil prices lead to a contraction in Persian Gulf economies, Bangladesh's remittances could be hit.

Foreign Direct Investment

¶9. (U) Bangladesh, like other developing nations, could see reduced levels of foreign direct investment (FDI) in the medium term. FDI numbers in Bangladesh, $666 million in 2007, have remained low in comparison to other Asian economies and have declined in the last couple years. At a time when Bangladesh's energy and infrastructure needs --areas that have attracted FDI here -- are greater than ever, the current credit crunch bodes ill for Bangladesh's ability to improve its FDI performance.

Foreign Assistance

¶10. (U) A few analysts have expressed concern that large bailouts by the USG and European governments could result in a future decline, at least temporarily, in those governments' ability to provide foreign assistance to developing nations, including Bangladesh. While foreign aid accounts for only 2 percent of Bangladesh's GDP, international donors play a leading role in areas critical to Bangladesh's long-term development, including infrastructure, health, and education.

Government Reassurance

¶11. (U) Top Government of Bangladesh (GOB) officials and the Governor of Bangladesh Bank have made public statements to reassure Bangladeshis about short and long term prospects for the nation's economy. Bangladesh Bank has been transparent in identifying where it and commercial banks hold the nation's foreign currency reserves, i.e. in safe financial instruments like U.S. Treasury bills. GOB and business leaders said they would monitor closely the impact of the crisis on Bangladesh's RMG sector and would seek measures to minimize threats to the sector. Bangladesh's leaders also are working to identify potential effects of the crisis on the nation's

poor. (NOTE: More than 80 percent of Bangladeshis subsist on less than two dollars a day. END NOTE.)

Comment

¶12. (SBU) Another casualty of the financial crisis could be the USG's ability to argue the merits of a market-based economy. In Bangladesh, where underlying economic beliefs tend more toward a managed economy than capitalism, the financial crisis is likely to provide ammunition for those who support a greater government role in the economy. Fortunately, Bangladesh's best known economist, Nobel laureate Muhammed Yunus, said publicly over the weekend that while government solutions were needed in the short run to address the current crisis, in the long run market mechanisms continued to be the best means of addressing economic challenges. In contrast, an economist affiliated with one of Bangladesh's main political parties last week pointed to the current crisis as a reason for the nation's next government to remain actively involved in Bangladesh's economy. As Bangladesh prepares for a transition back to democracy, we will need to work even harder to convince many Bangladeshi leaders that the key to economic growth here is less, not more, government intervention in the markets.

Moriarty